Impact of Merger and Acquisition Announcement on Stock Returns: Review of Literature

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Abstract

Current study investigates the impact of “Merger and Acquisition” event on stock returns of the acquiring firms. Previous researches have given a rise to so many questions with reference to the effect of “Mergers and Acquisition (M&A)” on returns of shareholders of the acquiring companies. The researchers tried to spotlight on the ‘domestic’ and ‘cross-border’ “Mergers and Acquisition (M&A)”. In this structure, the timing and the terms & conditions of the takeover are subjective. The thrust of the model for abnormal announcement returns are constant with the attainable experimental evidences. The deals are categorized in two parts: ‘cash-financed’ and ‘stock-financed’. The outcome of study recommends that response concerning “Mergers and Acquisition (M&A)” announcements are unforced and impulsive and the shareholders gain positive returns on an average during the announcement period. ‘Cash-financed’ deals create more value as compared to ‘stock-financed’ deals.

Keywords: Mergers and Acquisitions, Stock Return, Average Abnormal Return, Short-and-Long Run Performance, Stock price variations
Introduction

To serve variety of business objectives one of the preferred tool of corporate structure is “Mergers and Acquisition (M&A)”. With a splendid growth in the number of “Mergers and Acquisitions”, there has been growing interest in the issues with reference to the effect of these reformation undertakings on the productiveness of business. A fusion of two companies is known as “Merger”. When two companies comes together to form a new company, or one company joins another company then that is called as “Merger”. On the other hand, when once company takeover another company’s controlling stakes and the management control is taken by the acquirer then that situation is known as “Acquisition”. Acquisitions and Mergers are totally different from each other. In case of Merger, two companies surrender their independence and work together with common cooperation, on the other hand in Acquisition a company wilfully surrender their independence and gets adapted by the another firm. A bid is made by the acquirer for the target company which is called Corporate Action or Corporate takeover. An increased use of “Mergers and Acquisitions (M&A)” as means of inorganic growth for restructuring leading business enterprise. To become competitive by economies of scale and to achieve large size business and faster growth “Mergers and Acquisitions (M&A)” is found to be the best strategy. To match with the growing domestic and global markets Indian companies are also getting involved in “Mergers and Acquisitions (M&A)”.

There will be an effect of “Mergers and Acquisitions (M&A)” on stock returns only after announcement is made is what one would expect, but during pre-announcement period itself remarkable fluctuations in the share prices can be noticed. Impact of “Mergers and Acquisitions (M&A)” during pre-announcement and post-announcement period is examined in the present research. Relationship between the abnormal returns of post and pre-announcement has also been examined. For corporate governance and investor protection a well-developed regulatory framework is been applied by developed countries. Such frameworks are at its early years and there is insufficiency of rigid enforcement mechanism for the emerging market economies like India so that insiders do not harness their benefit of accessing the information which other shareholders do not have. Hence, there may be the cases of leakage of information and before the announcement of “Mergers and Acquisitions (M&A)” such leakages may get reflected by the movement in share prices. Pre-announcement of “Mergers and Acquisitions (M&A)” is been
observed in mature markets as well. Hence taking the window of 20 days (-1 day to -20 day) an attempt has been made to examine the effect of “Mergers and Acquisitions (M&A)” during pre-announcement period in this study.

Components of domestic and cross-border “Mergers and Acquisitions (M&A)” are very similar to each other. Though there are some unique features of cross-border “Mergers and Acquisitions (M&A)” because of its international nature, costs and benefits, there may be some viable businesslike dissimilarities in the goals for cross-border and domestic ‘acquisitions’. Cross-border “Mergers and Acquisitions (M&A)” involves unique challenges should not be ignored, these challenges and differences are caused because of different economic culture, and institutional structures between the two countries. Since cross-border “Mergers and Acquisitions (M&A)” are very complex because of various dissimilarities among the acquirer country and the target country, we should not treat cross-border “merger and acquisitions” as an expansion of domestic mergers and acquisitions. Managers of both the companies should consider the differences of cultural, environmental, legal and accounting rules between domestic and cross-border merger and acquisitions. Major reasons for why companies prefer to do ‘cross-border’ “mergers and acquisitions”. Some of the motives are as follows: Overcoming entry barriers, market power gets increased, diversification, speedy entry to the market and to overcome the cost of new product development. Some other reasons for cross-border “M&As” economies of scale can be achieved, external growth by extended market, availability of raw materials, labor and technology, protective ways to decrease earnings instability by diverse products and market at the same time exploitation of exclusive benefits like capable management, production, design, branding and reputation.

Remarkable reformations in size, philosophy in the management, geographical and product variation in global business environment and the turnover has been observed in the past two decades. To cope up with the unforeseen threats and possible capitalization opportunities available in the market one of the strategic decision taken by the business is “Merger and acquisition (M&A)” After globalization, privatization, deregulation and liberalization policies adopted by other economies of the world, Indian economy is also been noticed to make a rapid growth in “Merger and acquisition (M&A)”. Behind corporate growth and development by the help of corporate restructuring there are several motives, same can be categorized in two
sections: ‘Value maximizing motives’ and ‘Non-Value Maximizing’ motives. Corporate growth, economies of scale and economies of scope by corporate restructuring is the “Value maximizing motives” contrary to that increase in job security, manager’s passion to control large organization can be the purpose behind “Non-Value maximizing” motive. Growing trend of “Merger and acquisition (M&A)” can have other possible reasons as well like, technical growth, financial trouble in the industry, global merger of markets, increase in financial associations and regional restrictions.

Due to the complicated pattern of motives which at times intersect and challenge each other are the causes of merger as stated by most of the researchers. “Merger and acquisition (M&A)” is an major entrepreneurial agreement that firms take in their daily survival. With the fundamental goal of enriching shareholders wealth firms take decisions like “Merger and acquisition (M&A)”. When a firm become enough valuable after the merger than the simple two separate firms before the merger and it benefits the shareholders that is because of the result of “Merger and acquisition (M&A)”. As the firms are obtaining companies both domestically and globally throughout several industrial sectors of Indian economy “Merger and acquisition (M&A)” have considerably increased in India. Acquiring firms as well their shareholders are predicted to be the most beneficial parties by the strategic decisions that is “Merger and acquisition (M&A)” Operations of business gets strengthened by “Merger and acquisition (M&A)” is one of the popular belief.

**Literature review**

Mall and Gupta (2019) studied the behaviour of stocks at the time of “Merger and acquisition (M&A)” in the Indian banking sector. The impact on stock return and stock flippancy due to “Merger and acquisition” is also examined in this study. Apart from examining several factors influencing “Merger and acquisition” in the banking sector in India, it was also found that shareholders of acquiring banks in India generate abnormal returns. Straightforward relationship between “Merger and acquisition” affairs and stock spread was also been examined. Upward and downward form is been seen in pre and post event period during “Merger and acquisition” deals of banking sector. These returns gets negative slowly then again start growing. Hence, the entire
return form swings from upward to downward. On the contrary spread of returns increases on the day of declaration of “Merger and acquisition” and falls in the period of post-announcement.

Zakaria and Kamaludin (2018) found the logically constant delay in the positive reaction response by the investors few days post the declaration of “Merger and Acquisition” that can be exploitive, is opposite to what we predict under the efficient market conditions. Findings of the study hence bring to our knowledge about the arguments of real-world on corporate “Merger and Acquisition” with special connection to inefficacy of short and long run market. Delayed Positive response of investors is possibly continue in the long run. Confirmation of markets forecasting increased value for acquiring companies may not display short-run exaggeration as in the long-run over the following 36 months, shares of the acquirer companies continue to outshine the benchmarks of the market.

Rani, Yadav and Jain (2015) revealed that announcements of “Merger and Acquisition” usually brings positive reactions in the market. This study shows that the investors of acquirer involved in “Merger and Acquisition” sees a positive AR on the day of announcement also CARs on small multi-days event window throughout the declaration period. The examination shows wealth of shareholders rises as a result of “Merger and Acquisition” and profits are remarkably good during the course of event window of 2, 3 and 5 days adjacent to announcement. Positive ARs do not holdup and there will be powerful improvement in the market price of the acquirer firm and it all takes place post-declaration of “Merger and Acquisition”. The CAAR values goes negative around post-event window. Before the news of “Merger and Acquisition” an investor can gain good returns if the shares are purchased within 5 days before the news keeping in mind the investment point of view and sell those shares one day after the declaration. If an investor purchase the shares of the acquiring firm 2 days before the declaration day and sell the same 2 days after the announcement then in that case also an investor can gain good returns.

Neethu et al (2019) studied the viewpoint of shareholders with reference to announcement of “Merger and Acquisition”. By event study methodology it was found that on an average a shareholder earn positive returns during the period of “Merger and Acquisition” announcement. There is evidence irregularity in the Indian capital market, as the outcomes shows no remarkable
response to the announcement of “Merger and Acquisition” within immediate days. Does response of shareholders contrast with reference to the mode of payment is also been examined in this study. Shareholders makes profits from the cash-financed ‘merger and acquisition’ agreement, while they make losses from the stock-financed “merger and acquisition” contracts. Stock market response positively to the cash-financed “merger and acquisition” announcements on short-window while reacts negatively to the long-window. Shareholders do not gain any value from the stock-financed deals and also makes loss during the long-window. Shareholders are less confident about the stock-financed deals as there is risk element involved in it. There is a dissimilarity in ‘cash-financed’ and ‘stock-financed’ deals. With ‘cash-financed’ deals shareholders make good returns, on the contrary make loss from ‘stock-financed’ deals.

Sachdeva et al (2015) found that the shareholders of acquiring firms in Indian do not generate any positive value in the short run from the announcements of “Merger and Acquisition”. The experimental outcome received from the study recommends that the investors of the acquiring firm attains a positive average abnormal returns during the day of announcements of “Merger and Acquisition” only. The positive abnormal returns in the event period on the days which are before the announcement day have been noticed may be because of the circulation of news of the “Merger and Acquisition” before the exact date of announcement, that may sometime happened because of insider trading or rumors. A fall in the return have been noticed after the confirmed “Merger and Acquisition” of the companies. As per the findings of the study, shareholders of the acquiring firm goes through negative average abnormal return just after the announcement day. Although the outcome attained on the last day of the event period is precisely remarkable.

Kumara, Vidhya and Reddy (2019) studied the relationship between the announcement date of “Merger and Acquisition” and its practical result on the closing prices of the acquiring banks. There will be the rise in the movement of stock price of the bank that what a stakeholder would expect as the announcement of merger is made. In short run, the possibility of earning high returns than normal return is more after the announcement of merger is made. To check the investor’s probability of earning high return than normal returns after announcement of merger of the bank id the main purpose of this study and to examine if the stock price of the acquiring banks gets affected after the announcement of merger.
Edi and Irayanti (2019) studied that “Merger and Acquisition” is a type of corporate restructuring. With special motives one company adopts another. Growth, minimizing risk by diversification, collaboration, new business opportunities, internationalization are some of the main motives behind “Merger and Acquisition” of companies. “Merger and Acquisition” will have positive effect on the company if the company achieves its objectives after the merger, but in case those objectives are unachieved then it will be called as failure. This study examined the impact of “Merger and Acquisition” on the performance of the company. The outcome of the study shows that the profitability performance after the “Merger and Acquisition” display a remarkable fall, excluding GPR, it experiences less considerable fall after “Merger and Acquisition” and NPR experience negligible increase.

Kashiramkaand Rao (2012) revealed that with reference to the impact of “Merger and Acquisition” announcements on the wealth of shareholders, it can be said that the remarkable wealth gains are made by the target firms on ‘acquisition’ announcement at the time of announcement of the deals in the when capital market moving positively. Whereas there are wealth loss when the deals are announced at the time of negatively moving capital market. Contrary to this, in case of ‘mergers’, the target company enjoy remarkable gain in their wealth in the whole pre-announcement period but these gains to not continue in the post announcement time period. Research also shows that the target company attain more when the deal is framed as an ‘acquisition’. The proof of the same can be noticed from the fact that the number of ‘acquisition announcements is much more than the ‘merger’ announcements.

Conclusion

“Merger and Acquisition” is known to be one of the most practical and functional approach for the growth and enhancement of the business. To expedite the growth execution plan of the companies, “Merger and Acquisition” is found to be the most effective way. All industries are using “Merger and Acquisition” as a determined approach for growth and expansion. Blow-up in using “Merger and Acquisition” has given big space to companies to obtain growth in the market and it is not a new theory. Judgments that impact the scope of the company among the most major experienced by the management and among the most examined by the academics. The
The typical example of the same is “Merger and Acquisition”. “Merger and acquisition (M&A)” is one of the important entrepreneurial agreement that firms take in their daily operational life. Acquiring companies and their shareholders are expected to be the most benefited parties and companies attain growth by the decision of “Merger and acquisition”. The announcement of ‘merger and acquisition’ brings positive reaction in the market.

The study shows that the shareholders of the acquiring firm obtain abnormal returns. Returns in the banking sector increases on the day of announcement of ‘merger and acquisition’ and declines in the post announcement period. These results can be useful for the bank managers, shareholders, market regulators, consultants and researchers. To conclude, it can be said that the result of ‘merger and acquisition’ with reference to the performance of the stock can be varied in conformity with several factors like sample period, country selected for the study whether it is developed country or a developing country, data collection, if it is daily, weekly or monthly etc. method used to obtain results, etc. The deals are divided in two parts: Cash-financed deals and the stock-financed deals. Cash-financed deals create more value to the wealth of shareholders, whereas they face loses from the stock-financed deals. The outcome of the study shows that the reaction of the shareholders on the announcement of “Merger and Acquisitions” is totally unplanned and unforced and on an average they attain good returns.

References


